THE DETERMINANTS AND STABILITY OF MONEY DEMAND IN THE REPUBLIC OF UGANDA

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REGISTRATION NUMBER: 2016/HD06/1129U

A RESEARCH REPORT SUBMITTED TO THE GRADUATE SCHOOL IN PARTIALFULFILLMENT FOR THE AWARD OF MASTER OF ARTS IN ECONOMIC POLICY AND MANAGEMNET DEGREE OF MAKERERE UNIVERSITY.

ABSTRACT

The ability to model a stable relationship between money and prices is fundamentally considered a necessary requirement for a monetary targeting framework. Having a stable money demand function helps to ensure that the desired impact of monetary policy is predictable. The study undertaken sought to explain the determinants of money demand in Uganda employing cointegration analysis to establish the existence of a long-run relationship between Money, income, a vector of interest rates, inflation and real effective exchange rate in Uganda using quarterly data for the period 2001 to 2015. Post affirming the existence of a cointegrating relationship, an error correction model is obtained to help decipher the short run dynamics. The findings revealed that real M2 is positively related to real GDP with an income elasticity of 1.26 and negatively related to real effective exchange rate that had an elasticity of -0.59. The short-run model affirmed the existence of cointegrating relationships for the broad money model, 0.885 percent of adjustment to an exogenous shock occurs in one quarter. Tests on parameter stability indicated that the short-run models did not reveal any sign of instability. The recursive coefficients and residual estimates for the broad money model exhibited parameter constancy indicating that there is no evidence of a major instability over the sample period.